197146

SIDLEY & AUSTIN
A PARTNERSHIP INCLUDING PROFESSIONAL CORPORATIONS

1722 EYE STREET, N.W.
WASHINGTON, D.C. 20006
TELEPHONE 202 736 8000
FACSIMILE 202 736 8711

FOUNDED 1866

CHICAGO
DALLAS
LOS ANGELES
NEW YORK

HONG KONG
LONDON
SHANGHAI
SINGAPORE
TOKYO

WRITER'S DIRECT NUMBER
202-736-8198

WRITER'S E-MAIL ADDRESS
thynes@sidley.com

RECEIVED
FEB 29 2000
MAIL
MANAGEMENT
STB

February 29, 2000

ENTERED
Office of the Secretary

FEB 29 2000

Part of
Public Record

Honorable Vernon A. Williams
Secretary
Surface Transportation Board
Case Control Unit
Attn: STB Ex Parte No. 582
1925 K Street, N.W.
Washington, D.C. 20423-0001

Re: STB Ex Parte No. 582; Public Views on Major Rail Consolidations

Dear Mr. Williams:

Enclosed for filing in the above-captioned proceeding are the original and ten (10) copies of the Testimony of Robert J. Ritchie, President and Chief Executive Officer of Canadian Pacific Railway Company. Also, enclosed is a computer disk containing a copy of this submission in WordPerfect format.

Please date-stamp the two (2) extra copies of the enclosed filing and return them via our messenger.

Sincerely,

Terence M. Hynes

Terence M. Hynes

Enclosures

# TESTIMONY
# OF
# ROBERT J. RITCHIE
# PRESIDENT AND CHIEF EXECUTIVE OFFICER
# CANADIAN PACIFIC RAILWAY COMPANY

Canadian Pacific Railway Company ("CPR") operates a 14,400-mile rail network that serves all of the principal business centers of Canada, as well as 16 states in the U.S. Northeast and Midwest. CPR's recent history is somewhat unique among North America's Class I railroads -- we are the only major Class I carrier that has not participated in a merger or consolidation transaction during the past five years. We have instead focused our recent efforts on improving the quality, efficiency and safety of our rail network. During the past three years, CPR has invested nearly $3 billion to renew our physical plant, modernize our locomotive fleet, expand yard and terminal capacity, and deploy improved information systems. These investments have positioned CPR to offer the superior level of rail service demanded by our customers, and to compete more effectively with other railways and motor carriers for their business.

CPR is deeply concerned about the proposed merger of BNSF and CN -- and, more fundamentally, about the prospect of another full round of rail mergers -- at the present time. In the current rail industry environment, further major restructuring could be harmful to both our industry and our customers. Yet, the decision of BNSF and CN to merge now may force CPR and the other Class I railroads to pursue further consolidation before the service problems created by the last round of mergers can be cured, and shippers have seen the benefits promised to them in connection with those prior transactions. CPR believes that the more prudent course for the industry at this time would be to focus our attention on solving those problems, and working together to improve the reliability of rail service.

CPR's position is based upon a number of factors:

**Service Reliability.** The service problems caused by the last round of rail mergers have adversely affected the ability of ***all*** of the Class I systems, including CPR, to deliver consistent, on-time service. A defining characteristic of the rail industry is our interdependence -- we must rely upon one another to deliver our customers' freight to points beyond our own lines. The service failures that have occurred in implementing recent mergers have impacted not only the merging railroads, but have been felt across the entire North American rail network. While CPR has not been a direct participant in any of the recent mergers, these service failures have affected us, and our shippers, in two ways.

In some instances, line congestion and terminal delays caused by the mergers have hampered CPR's own train services. Our D&H subsidiary has incurred millions of dollars in additional fuel, crew and equipment costs as a result of traffic congestion in the Northeast following implementation of the Conrail transaction. Switching delays in the New York and Philadelphia Shared Asset Areas have undermined our efforts to utilize the trackage rights and pricing authority that we obtained in the *Conrail* case to provide competitive service to those areas. Congestion in the Chicago and St. Paul terminal areas following UP's acquisition of CNW likewise adversely affected CPR's operations in those areas. The UP/SP merger also created equipment shortages that impaired CPR's ability to serve our automotive and intermodal customers.

Merger-related operating problems have impaired the quality of rail service available to CPR's customers even where CPR's own train operations were not directly affected. Traffic interchanged by CPR to connecting U.S. railroads has been delayed or misrouted on the lines of

U.S. carriers attempting to cope with service disruptions resulting from their mergers. At the height of the service crisis that followed the UP/SP merger, interline shipments that normally move in 15 days took 35 days or more to complete. We saw similar problems with shipments to the Northeast following the breakup of Conrail, and also experienced delays on shipments to BNSF's territory after their merger with the Santa Fe. The impact of these service failures has been felt across the CPR system -- indeed, shippers as far away as British Columbia have been impacted by the recent service problems in the U.S. Northeast. Customers affected by these problems are understandably unhappy with us. In a number of instances, shippers have simply given up on the railroads and diverted their freight to other modes of transportation.

**Shipper Confidence.** Perhaps the most troubling consequence of the service problems resulting from recent rail mergers is that many of our customers have lost faith in the ability of the rail network to deliver consistent, reliable service. This loss of confidence comes at a particularly unfortunate time, as new logistics practices and economic growth have generated greater demand for high quality, on-time transportation service. By failing to meet the expectations of our customers, the rail industry is missing an opportunity to leverage the investments that we have all made in our infrastructure to grow our business -- and, in particular, to take trucks off the highways. Indeed, the instability of rail service has led some shippers to transfer to other modes business that previously moved by rail.

In order to restore shipper confidence in rail transportation, the service problems created by recent mergers must be fixed, and the rail industry must prove that it can provide on-time, problem-free service on a consistent basis. This cannot be accomplished "overnight." It will require a significant period of service stability -- and improvement -- for the rail industry to regain the confidence of the shipping community. Indeed, it has taken CPR more than 2 years to persuade some customers who switched to trucks during the UP/SP service crisis to try rail service again, even on a trial basis.

The proposed BNSF/CN merger threatens to destabilize further an already fragile rail service environment. If the BNSF/CN combination goes forward, it will generate substantial changes in rail traffic routing and interchange patterns. Traffic formerly handled by BNSF in cooperation with CPR will be directed to BNSF-CN routes. Likewise, CN can be expected to shift to BNSF traffic that it previously handled with UP. Indeed, BNSF and CN have stated publicly that they intend to divert more than $300 million worth of traffic in this manner annually, and they also plan to shift large volumes of rail traffic to new gateways. The competitive responses of the remaining Class I railroads will generate additional changes in train service, traffic routing and interchange patterns. Recent experience strongly suggests that these changes will inevitably result in more service failures, at least in the short term.

Moreover, the proposed BNSF/CN transaction is the first large-scale rail merger involving major carrier systems in both Canada and the United States. Notwithstanding its recent acquisition of Illinois Central, CN is, like CPR, primarily a Canadian railroad. The requirement that BNSF/CN comply with the laws of two nations adds a layer of complexity that could potentially create problems (at least in the short term) in implementing their proposed merger.

In short, another round of restructuring now will almost certainly prolong the current state of service instability. If we embark on such a course, we run the risk of alienating shippers for the longer term. This may result in the loss of traffic and revenue to other modes, impairment of our ability to attract capital, and proposals for greater regulation that could threaten our industry's long-term vitality.

**Alternatives to Merger.** The recent round of rail consolidations has produced a balanced geographic structure, with two major Class I systems serving the Eastern United States, Western United States and Canada, respectively. The resulting balance, and the reduction in the number of major industry players, creates an environment in which Class I carriers may find it easier than in the past to pursue a variety of initiatives to improve the quality of interline service. Such possibilities include the use of information technology to make interline service more "seamless" to the customer, and cooperative efforts to expedite the movement of traffic through busy terminal areas. These measures can make our interdependent rail network more responsive to shippers' needs, and more competitive with other modes of transportation.

In addition, the current geographic balance creates opportunities for Class I railways to pursue strategic partnerships, and other arrangements short of merger, to reduce their costs and improve the attractiveness of their joint service offerings. CPR has been evaluating such opportunities with several U.S. Class I carriers. Likewise, CN announced last year the formation of an "Alliance" with KCS designed to enable those railways to provide seamless rail service in the growing NAFTA Corridor. (CN's proposed merger with BNSF -- which serves many of the same end markets as KCS -- certainly calls into question the future of the CN-KCS Alliance. CN barely gave that much-touted arrangement any time to work before forging a new "alliance" with BNSF.) CPR believes that the industry -- and our customers -- would benefit from an opportunity for carriers to explore the potential of such cooperative ventures.

However, the recent BNSF/CN merger proposal will force the remaining Class I carriers to respond competitively -- and to do so quickly. No carrier -- including CPR -- can afford to stand idly by if BNSF and CN are permitted to create the largest railway on the continent. Other railways will need to extend their size and geographic reach in order to compete effectively with a combined BNSF/CN in cross-border markets, and to maintain comparable financial strength. Prior industry experience suggests that this industry response will inevitably take the form of more merger proposals (rather than strategic partnerships short of merger). This process will divert management resources to the pursuit of those transactions, at a time when our primary focus should be -- indeed, it must be -- on restoring shipper confidence by delivering excellent service. (Indeed, CPR has been forced to devote substantial management time to such strategic issues following the announcement of the proposed BNSF/CN merger.) In the process, the industry will forego an opportunity to pursue cooperative initiatives that might improve the rail system as a whole, and to explore alternatives to merger that have the potential to generate substantial public benefits by less disruptive means. Moreover, the remaining Class I carriers may be pressured into precipitous actions that could ultimately produce an asymmetrical, and competitively imbalanced, North American rail system.

**Impact on Capital Markets.** CPR is concerned that a new wave of rail consolidations, at a time at which the industry has not yet fully recovered from the adverse effects of prior mergers, may impair the railroads' ability to attract capital. If we fail to meet our customers' requirements, they will vote with their feet, and rail traffic and earnings will decline. This will tarnish the attractiveness of the railroads in capital markets, making it more difficult (and costly) for carriers to attract capital. (It is certainly no secret that the railroads' recent service problems have hurt us on Wall Street as well as in the shipper community.) The long-term consequence of such an occurrence would be to impair the industry's ability to make the investments necessary to meet the future needs of our customers, to grow our business and to introduce new information technology applications.

* * * * * *

The announcement of the proposed BNSF/CN merger has generated a great deal of speculation about a new round of rail consolidations -- perhaps resulting in the creation of two continent-wide rail systems. Whether, or when, other transactions will be proposed remains to be seen. However, because a final round of consolidations would fundamentally alter the North American rail system, the STB cannot view any single "mega-merger" proposal in a vacuum. CPR endorses the Board's announced intention to consider the potential cumulative impacts of the proposed BNSF/CN transaction, and any responsive merger that may be proposed, in the upcoming BNSF/CN proceeding. CPR urges the Board to evaluate all such proposals under consistent standards, and to apply any new or revised regulations or policies that the Board may deem necessary in light of the testimony presented in this proceeding to all proposed mergers, including the pending BNSF/CN transaction.